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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR APPROVAL OF REVISIONS TO ITS RATE SCHEDULE NO. T-1, TRANSPORTATION OF CUSTOMER SECURED NATURAL GAS.	DOCKET NO. G-01551A-06-0746 **COMMENTS AND EXCEPTIONS OFFERED BY SIERRA SOUTHWEST COOPERATIVE SERVICES, INC.**

Sierra Southwest Cooperative Services, Inc. (Sierra) submits these comments and exceptions to the recommendations of Arizona Corporation Commission (Commission) Staff in the June 12, 2007, memorandum and proposed order for the above-referenced matter. Sierra commends the Staff for providing interested parties an opportunity to participate in open workshops. It also commends Southwest Gas Corporation (SWG) for considering the comments of customers and marketers, and addressing a number of their concerns in the final revisions to its rate Schedule No. T-1, Transportation of Customer-Secured Natural Gas (the T-1 Tariff).

If, however, SWG's application to revise its T-1 Tariff is approved without first resolving the issue of how it will pass through and allocate penalties assessed on SWG by El Paso Natural Gas Company (El Paso) to SWG's transportation customers, recent experience suggests that such uncertainties will have a devastating impact on Sierra's natural gas marketing business and will undercut the Commission's natural gas open access program in Arizona.

Sierra recognizes that the Commission faces a difficult job of balancing the interests of transportation customers and core customers and contends that requiring SWG to adopt a reasonable and equitable penalty allocation policy will go far to accomplish this goal. Indeed, the outlines of such a policy have already been formulated. Sierra therefore urges that the approval of the T-1 Tariff revisions be conditioned on SWG amending its tariff revisions, or issuing a formal statement of policy, setting forth a modified penalty allocation methodology substantially as it has been described by SWG staff in informal discussions with Sierra, more specifically described below.

Background

Sierra is an Arizona non-profit electric generation and transmission cooperative corporation with its headquarters in Benson, Cochise County, Arizona; and with its sales division operating in Tucson, Pima County, Arizona. Sierra is engaged in various business activities, one of which is selling natural gas as an independent marketer pursuant to applicable rules and tariffs providing retail open access to natural gas supplies for customers meeting certain threshold quantity usage requirements. As such, Sierra purchases natural gas from suppliers for resale to qualifying commercial customers in Arizona with delivery through local natural gas distribution companies, including SWG.

Because revisions proposed by SWG to its T-1 Tariff will directly and significantly affect its natural gas marketing business in Arizona, Sierra requested to intervene in these proceedings and the request was granted by the Commission on May 21, 2007.

Initial Allocation of Penalties by SWG

Sierra transports natural gas supplies to its customers over the interstate natural gas pipeline operated by El Paso. Like SWG, Sierra holds firm transportation rights under tariff rate schedule FT-1, as approved by the Federal Energy Regulatory Commission (FERC), through its Transportation Service Agreement (TSA) with El Paso. SWG and SSW, therefore, each have firm rights to a maximum daily quantity (MDQ) of gas at certain delivery codes (D-Codes) on

El Paso's system. Sierra and its customers have no right to use SWG's firm rights to get gas delivered by El Paso to the D-Code, and SWG has no right to use Sierra's firm rights. Each must deal with El Paso separately.

In conjunction with El Paso's recent efforts to modify the use of D-Codes and to define the maximum delivery obligation (MDO) at its physical delivery meters within the D-Codes, Sierra responded to inquiries by El Paso, providing pertinent customer information, including historic usage. This information was incorporated in the Operator Point Aggregation Service (OPAS) agreements between El Paso and SWG providing for MDO limitations at each of El Paso's physical meters in D-Codes wherein SWG is the point operator. The OPAS agreements, which have been endorsed in principle by FERC, effectively make it the point operator's responsibility to ensure that volumes in excess of the applicable MDOs are not accepted at an applicable meter, and impose penalties—which can be very high when a "critical operating condition" has been declared by El Paso—on the point operator for violations of such MDO limitations, regardless of whose gas was being received at the time.

It is worth noting that while SWG has signed an OPAS Agreement with El Paso, it has for some time been protesting the MDO allocation process at FERC in Docket No. RP05-422-000, et al. In summary, SWG argues that MDO allocations are inadequate to allow for fluctuating requirements at its individual meters, which necessarily subjects it to unjustified penalties, and El Paso has responded that the problem is not with the total MDO amounts but rather result from a misallocation of MDO amounts at meter points resulting from information provided by SWG in the development of the OPAS.

Beginning January 1, 2007, El Paso began enforcing the applicable MDO limitations, and penalizing point operators for MDO violations at various delivery points. SWG immediately began passing through penalties to transportation customers who exceeded their operating rights at certain meter points. Alarmingly, the allocation methodology used by SWG resulted in a disproportionate assessment of such penalties against transportation customers. The apparent basis for this disproportionate assessment was SWG's assertion at the time that transportation customers have no MDO rights at meters wherein SWG is the point operator, and therefore that all the MDO rights at such meters belong exclusively to SWG and its core customers. Thus penalties resulting from MDO violations were attributed first to transportation customer volumes, without applying the MDO rights assigned in the applicable OPAS agreement on a pro-rata basis to such volumes. This was so, even when such MDO rights were based in part on the historic usage of the transportation customer as incorporated into the applicable OPAS agreement. Although the existing T-1 Tariff authorizes SWG to pass through penalties resulting from MDO violations, nothing in the tariff provides that such a pass through may be disproportionately assessed against transportation customers.

As point operator, SWG is responsible for handling all shipments to customers behind El Paso's meters, not just shipments delivered under SWG's own TSA's with El Paso. SWG is also clearly responsible to work with El Paso in good faith to ensure an allocation of MDO rights sufficient to cover total volumes behind a meter, including transportation customer volumes. If transportation customers are to bear some of the costs of penalties assessed by El Paso, the Commission must require any pass through of penalties to be allocated rationally among all customers behind a meter, sales and transportation alike, based on the their respective rights to receive gas through that meter. For the Commission to do otherwise would be for it effectively to abandon its open access program by allowing SWG to put Sierra, and other marketers, at an insurmountable disadvantage in competing for the business of gas customers located on SWG's system.

Impact of Penalties on Sierra's Business

Sierra, one of many natural gas marketers in Arizona with a significant number of transportation service customers on the SWG system, has invested millions of dollars to establish its business both for the benefit of Sierra's members and for the benefit of Arizona consumers. Recently, however, because the method SWG has used to pass through penalties has not been clearly defined, and because of the potential magnitude of these penalties (over which many customers have little or limited control), new customers are reluctant to switch from sales service to transport service under the T-1 Tariff, even when transportation service may offer substantial savings. The current tariff proposal offers no definitive methodology on which a customer may reasonably rely to minimize the potential of being penalized. Without an explicit policy, which would allow the customer to make an informed business decision with some assurance of risk certainty, most customers will not take advantage of transportation service.

To compound the uncertainty, customers considering switching from sales service to transportation service must jump through a number of hoops, which taken together, amount to a considerable disincentive to making such a switch. The customer must first meet with representatives of SWG and enter into an agreement with SWG prior to becoming a transportation customer. During this meeting, SWG informs potential transportation customers of the uncertainties associated with doing business as a transportation customer and the likelihood for significant penalties. Following the meeting, if the customer is still interested in becoming a transportation customer, the customer can then expect significant delays and a lack of firm commitment as to when transportation service can be established. Because natural gas markets fluctuate significantly, the economics of switching from sales service to transportation service will be drastically different three or four months after a customer initiates the process.

Sierra is, nevertheless, optimistic that the process of switching to transportation service will become smoother over time, and implementation more timely. Sierra also recognizes that, as a result of the significant operational challenges imposed by El Paso, penalties cannot realistically be eliminated. Customers considering whether to switch to transportation service, however, should be able to turn to the tariff or other statement of policy issued by SWG to understand how penalties will be implemented and to determine what their exposure might be.

Approving the proposed tariff, without requiring SWG to commit to a more clearly defined and equitable penalty allocation methodology, creates significant disincentives to participation in the transportation service program, and improperly encourages existing customers to return to SWG sales.

Representations Made by SWG to Modify Penalty Allocations

At the May 9, 2007, Commission workshop on this matter, attended by representatives of SWG, El Paso, a number of transportation customers and marketers including Sierra, SWG committed to provide Sierra with a letter setting forth its revised penalty allocation policy assigning penalties on a pro rata basis between core and transportation customers with firm rights to a delivery meter. SWG further represented that it would apply this new penalty allocation policy retroactively to its customers.

Following the May 9, 2007, workshop, as they continued to refine their penalty allocation policy, SWG verbally informed Sierra that it would adopt a methodology that, at a minimum, would include the following guidelines:

1. That transportation customers holding firm FT-1 rights on El Paso's system with corresponding rights to certain physical delivery meters will not be subject to penalties as long as they do not exceed its meter allocations; and,

2. That transportation customers holding firm FT-1 rights on El Paso's system with delivery rights to the customer's D-Code but not specific rights to a physical delivery meter—or that had exceeded their rights at that meter—will be subject to applicable penalties if SWG receives penalties at the customers' meter, but the penalties will be allocated on a pro-rata basis over all customers, core and transportation, alike, behind that specific meter.

Sierra believes that the foregoing guidelines are a reasonable and proper methodology for allocation of penalties among customers at constrained meters, and commends SWG for agreeing to them. Unfortunately, however, SWG has not amended its proposed tariff or otherwise issued a written policy statement on its new penalty allocation policy, and, as has been explained, the resultant uncertainty continues to put Sierra at a significant competitive disadvantage in marketing its services to potential customers on SWG's system. Sierra therefore urges the Commission to condition its approval of the proposed SWG tariff on SWG's filing of an amended tariff, or otherwise to issue a policy statement, that clearly recites SWG's new guidelines for allocating MDO penalties.

To date neither the letter promised by SWG, nor any other statement of SWG's modified penalty allocation policy, has been received by Sierra. Nor is Sierra aware of any information exchange between El Paso and SWG that would formally recognize Sierra's FT-1 rights at specific physical delivery meters.

Conclusion

The Commission should amend Staff's proposed order to include a condition that SWG amend its tariff or formally adopt a policy statement setting forth a penalty allocation methodology that takes into consideration transportation customers with firm FT-1 rights on the El Paso system, and that otherwise provides for an equitable pro rata allocation of penalties behind physical delivery meters. Properly constructed, such a policy statement will balance the interests of core customers and transportation customers, and it will help ensure the continued viability of the open access program in Arizona.

RESPECTFULLY SUBMITTED this 22nd day of June, 2007.

Sierra Southwest Cooperative Services, Inc.

By [signature]

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